G-010/M-90-399 ORDER ESTABLISHING CIP COST RECOVERY PLAN
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BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Darrel L. Peterson	Chair
Cynthia A. Kitlinski	Commissioner
Norma McKanna	Commissioner
Robert J. O'Keefe	Commissioner
Patrice Vick	Commissioner

In the Matter of the Proposed Cost Recovery Plan for Midwest Gas Utility's Conservation Improvement Program

ISSUE DATE: November 28, 1990

DOCKET NO. G-010/M-90-399

ORDER ESTABLISHING CIP COST RECOVERY PLAN

PROCEDURAL HISTORY

On June 4, 1990, Midwest Gas Company (Midwest or the Company) filed a proposed Conservation Improvement Plan (CIP) cost recovery plan. The filing actually consisted of two optional plans to be considered.

On June 13, 1990, the Commission sent a notice to interested parties soliciting comments on the Company's proposals.

On July 31, 1990, NSP Gas Utility filed comments. The Department of Public Service (the Department) and the Office of Attorney General (OAG) filed comments on September 4, 1990.

On September 14, 1990, the Company and the OAG filed reply comments.

The matter came before the Commission on November 1, 1990.

FINDINGS AND CONCLUSIONS

The Midwest Proposal

Midwest's proposal for CIP cost recovery consisted of two possible recovery plans. Midwest preferred an annual CIP Adjustment (CIPA) plan, which would be billed monthly to recover projected CIP expenditures in excess of those collected in base rates during the CIP year. At the end of the CIP year, Midwest would true up its actual expenditures to collections by means of a Reconciliation Adjustment. This adjustment would be recovered over the following ten months. The CIPA plan would thus require a minimum of two rate changes annually, one when the adjustment was applied and one when the true-up amount was applied. Midwest proposed that the rate changes be implemented with minimum regulatory oversight, in a manner similar to the operation of Purchased Gas Adjustments.

Midwest proposed a second cost recovery alternative if the CIPA plan were rejected by the Commission. Under the second proposal, a deferred debit account, or tracker, would be created to record monthly CIP expenditures and recoveries. These items would be balanced in the Company's next general rate case.

Both of the Company's proposed options shared the following provisions:

1. Carrying charges equal to the Company's currently allowed rate of return;

2. Recovery of lost margins due to program participation; and

3. An incentive bonus for exceeding conservation goals.

Comments of NSP

In its filed comments, NSP supported Midwest's CIPA proposal. NSP preferred the CIPA method to a tracker account because under CIPA current costs would be borne by current ratepayers rather than deferred to future rate case proceedings.

Comments of the OAG

The OAG stated that Midwest's CIPA proposal was not legally permissible. The OAG noted that the CIPA plan would consist of a monthly energy charge adjustment (although the true-up would be annual). Only certain enumerated types of monthly adjustments are allowed under Minnesota rule or statute. CIP costs are not included under any of the permitted categories.

The OAG stated further that CIP expenses are subject to review in the general rate case process. If the annual adjustment method were adopted, any expenses disallowed in the rate case would need to be refunded. According to the OAG, this would result in an administratively burdensome situation.

The OAG supported Midwest's proposed tracker account method of CIP cost recovery.

Comments of the Department

The Department agreed with the OAG that the annual adjustment method was probably not legally permissible. After meeting a number of times with the Company and the OAG, the Department developed a modified tracker account method of cost recovery. The Company's basic plan was adopted in the Department's comments, with several modifications.

The first modification to the Company's basic tracker account plan was in the measurement of energy savings. Midwest proposed to measure residential and commercial conservation savings by analyzing normalized consumption levels before and after participation in its CIP programs. The Department recommended that this method be modified for residential customers by calculating the mean savings for all participants, performing a 95% confidence interval around the mean, and removing observations outside the interval before summing savings. This modification would isolate the savings which most likely resulted from program participation, and would help to eliminate savings which might have occurred or failed to occur due to other circumstances.

The Department recommended a more basic modification to the Company's proposed measurement of energy savings for commercial customers. According to the Department, there are too many variables in the commercial class to allow a simple weather-normalized consumption comparison. The Department proposed that commercial class savings be measured by drawing a sample of non-participants with comparable gas use histories as program participants, determining the mean change in consumption for both groups, and eliminating observations which fall outside a 95% confidence interval. The Company would recalculate the mean change of both populations and subtract that of the conservation group from the control group to derive the average savings of the conservation group over what consumption may have been had they not participated in the program. This value would be multiplied by the number of participants to determine the overall MCF saved and to calculate lost margins.

The Department also recommended a blend of the lost margin and incentives portions of the Company's proposal. The Department recommended that Midwest recover only 50% of the margin lost due to CIP, rather than the full amount as the Company had proposed. The Department suggested that an incentive program be added to the margin proposal. Under this plan, the Company could recover lost margins up to 60% if it exceeded its CIP goals. At the same time, the Company could experience reduction of lost margin recovery to 40% if it failed to achieve its CIP goals.

Commission Action

The Commission agrees with the Department and the OAG that the Company's tracker recovery plan is preferable to the proposed annual CIP Adjustment. There is no basis for a monthly adjustment of CIP costs in statute or rule. CIP expenses can also be distinguished from the types of energy charge adjustments, such as purchased gas, which are permitted under statute. CIP expenses tend to be predictable, not subject to the potential price fluctuations which affect fuel markets. CIP expenses are also subject to special scrutiny in general rate cases before recovery is allowed. Automatic adjustments would defeat the purpose of rate case review.

The Commission approves the Department's modified deferred debit account plan for CIP cost recovery.

The Department Proposal

The Department's plan for CIP cost recovery consists of a deferred debit account with provisions for carrying charges, recovery of lost margins, and incentives. The deferred debit, or tracker, method has been used within the context of CIP operations for several years. It has proven a useful means of balancing the financial needs of utilities with ratepayers' need for protection.

Carrying charges, incentive plans, and recovery of lost margins are new or nearly new additions to CIP cost recovery. They are discussed below.

Carrying Charges

The Commission agrees with the Department that a carrying charge added to the tracker account is an equitable method of adjusting actual CIP expenditures to CIP projections.

Ideally, a utility will actually spend exactly the amount it has projected it will spend on CIP projects. The utility will have projected CIP expenditures in its last general rate case, and will be allowed to recover CIP costs on an ongoing basis through rates.

If there are differences between projected and actual expenditures, they will be "tracked" and will be adjusted in the utility's next general rate case. If the company has underprojected and therefore undercollected, however, it will not be made whole if it simply receives the dollar amount of its undercollection in the next rate case. The utility will have lost the value of the use of the money during the time it has "lent" money to the CIP program. This is the point at which the carrying charges come into play.

Carrying charges represent the value of the use of money which is paid by the Company into CIP programs due to undercollection. Carrying charges should properly be set at Midwest's last approved overall rate of return, because this represents the best estimate of the Company's cost of capital. In other words, if the Company had not been required to carry funds in the CIP tracker, it could have invested the money and received a return on it. It is therefore equitable to set carrying charges at the Company's current rate of return.

The same reasoning applies if the Company has overcollected CIP funds through rates. In that case, the ratepayers have "lent" money to the CIP program, pending an adjustment in the next rate case. Adding a carrying charge to the CIP tracker will allow ratepayers to be made whole for the money they have expended on CIP programs.

Midwest has filed a general rate case since it submitted its CIP cost recovery plan. The Commission has set interim rates for Midwest until a final rate is approved in the ongoing general rate proceeding. In the Matter of the Application of Midwest Gas, a Division of Iowa Public Service Company, for Authority to Increase its Rates for Gas Service in the State of Minnesota, Docket No. G-010/GR-90-678, ORDER SETTING INTERIM RATES (November 9, 1990). Since the interim rate of return represents the latest estimate of the Company's cost of capital, the Commission finds that this rate should be applied to carrying charges. When the general rate case is concluded, carrying charges should be adjusted to reflect the approved final rate of return.

The Commission will approve a carrying charge added to the Midwest CIP tracker account. The carrying charge will be set at the interim overall rate of return until final rates are in effect.

Lost Margin Recovery and the Incentive Proposal

Little natural incentive exists for utilities to reduce energy consumption. Utility rates are set in a manner which encourages utilities to increase sales between rate cases. All utilities lose their margin on units of energy which are conserved rather than sold. The margin consists of the utility's profit and contribution to fixed costs.

CIP programs were enacted to require utilities to encourage energy conservation. These programs have been important tools in fostering national energy self-sufficiency and combating acid rain and global warming.

Recently there has been considerable national and state level discussion of incentives for utility investment in conservation. There is a growing feeling that utilities will respond to incentives with enthusiasm and innovative programs. Advocates of incentives suggest combining the "carrot" and the "stick" approaches: financial incentives with statutory mandates such as CIP.

There is particularly good reason to apply innovative approaches to conservation in the gas utility industry. Gas utilities differ from electric utilities in that the gas business is commodity-intensive. This means that the marginal cost of gas is low enough that it generally costs less to sell a unit of gas than to conserve one. Gas utilities do not share the opportunities for cost-avoidance that electric utilities possess. In the electric industry, conservation can often defer or avoid capital expenditures for new plant facilities. For gas utilities, which are not vertically integrated, reduction in sales simply means a reduction in margin.

The Commission finds that the Department's incentive plan is an imaginative method of addressing the lost margin issue while encouraging conservation through financial means. Limiting lost margin to 50% is an appropriate feature, especially on an experimental basis. At the same time, the Company can be rewarded for excellent performance or penalized for poor performance by a 10% increase or decrease in lost margin recovery. The plan is an excellent balance of Company incentive and ratepayer protection.

The Commission finds that the Department's proposed incentive plan should be implemented.

ORDER

1. The Commission approves a CIP cost recovery plan for Midwest consisting of a deferred debit account, or tracker, with a conservation cost recovery charge to be built into rates in the Company's ongoing general rate case.

2. A carrying charge will be applied to the under- or over-recovered tracker balance equal to the Company's most recently approved overall rate of return, including that set in the interim rates proceeding in the current rate case. When the general rate case is concluded, the carrying charge will be adjusted from the interim rate of return to the final approved rate of return.

3. Midwest shall file an annual report on the CIP year tracker collections, expenditures and balance, to be filed by November 1 of each year.

4. A pilot incentive program for recovery of lost margins shall be implemented, as outlined in this Order. To ensure further ratepayer protection, the following features shall be included in the incentive program:

   a. The pilot program shall run for a two-year period, to coincide approximately with the Company's 1990-1992 CIP years.

   b. Within 30 days after the close of its 1990-1991 CIP year, the Company shall submit a one-year status report detailing its performance and application of the incentive.

   c. Within 60 days of the date of this Order, the Company shall file a plan describing how it intends to evaluate the incentive at the end of the second year. The evaluation plan shall include an analysis of the impact of the incentive mechanism on the cost-effectiveness of CIP projects.

   d. Within 60 days of the date of this Order, the Company shall submit its proposed weather normalization method for Commission approval or modification.

   e. Recovery for lost margins shall occur only between rate cases. Conservation included in a test year forecast shall not be eligible for incentives.

5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Richard R. Lancaster
Executive Secretary

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